DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/22/07**	Bill No:	**AB 831**
Tax:	**Sales and Use** **Special** **Property**	Author:	**Parra**
Related Bills:			

BILL SUMMARY

This bill would modify the provisions related to the annual tax expenditures report prepared by the Department of Finance (DOF) to require the Legislature, on July 1, 2009, and on each July 1 of each 10th year thereafter, to review all of the tax expenditures and repeal those tax expenditures that do not advance or serve a public purpose or policy, as specified. This bill would also require that any bill creating a new tax expenditure, beginning January 1, 2008, provide only one tax expenditure and include a factual statement of the public purpose advanced or served by that expenditure.

ANALYSIS

CURRENT LAW

Since 1971, pursuant to Section 13305 of the Government Code, the DOF has been required to provide a tax expenditure report to the Legislature. Chapter 1762, Statutes of 1971, required that a biennial report be submitted to the Legislature, and that the report include the following: a comprehensive list of tax expenditures, additional detail on individual categories of tax expenditures, and historical information on the enactment and repeal of tax expenditures. Chapter 268, Statutes of 1984, increased the reporting frequency from once every two years to once a year.

Effective January 1, 2007, Assembly Bill 1809 (Chapter 49, Statutes of 2006, Committee on Budget) modified the DOF annual report to require them to provide a report to the Legislature by September 15th of each year on each tax expenditure exceeding $5 million annually. A tax expenditure is defined as a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by state law. The required report is to include each of the following:

- The statutory authority for tax expenditures.
- A description of the legislative intent for a tax expenditure, where the act adding or amending the expenditure contains legislative findings and declarations of the intent, or such intent is otherwise expressed or specified by the act.
- The sunset date of tax expenditures, if applicable.
- A brief description of the beneficiaries of the tax expenditure.
- An estimate or range of estimates for the state and local revenue loss for the current fiscal year and the two subsequent fiscal years. For sales and use tax expenditures, this would include partial year exemptions and all other tax expenditures when the Board has obtained such information.

- For sales and use tax and personal and corporation tax expenditures, the number of returns filed or taxpayers affected, as applicable, for the most recent tax year for which full year data is available.
- A listing of any comparable federal tax benefit, if any.
- A description of any tax expenditure evaluation or compilation of information completed by any state agency since the last report made under this section.

PROPOSED LAW

This bill would amend Section 13305 of, and add Section 13305.5 to, the Government Code to do the following:

1) Define "tax expenditure" as a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by state law.
2) By July 1, 2009, and by July 1 of each 10th year thereafter, require the Legislature to review all of the tax expenditures that have been existence since January 1, 2008, and require the Legislature to repeal those tax expenditures that do not do either of the following:
   - Advance a public purpose or policy;
   - Serve a public purpose or policy.

   This provision does not apply to tax expenditures related to food, prescription drugs, health services, or residential rent.
3) Effective January 1, 2008, provide that any legislative measure creating a tax expenditure will meet both of the following requirements:
   - The measure may only provide for a single tax expenditure;
   - The measure will include a factual statement of the public purpose or policy that is to be advanced or served by the expenditure.

BACKGROUND

There have been several bills introduced during the last few years related to tax expenditure reports. These include:

AB 1933 (Coto, 2006) would have required: 1) the DOF to review, over a 10-year period, all tax expenditures in excess of $1 million that were in existence since January 1, 2007, as specified; and 2) any legislative measure creating a new tax expenditure, or extending the operation of an existing tax expenditure, to meet certain requirements, as specified. This bill failed passage in Senate Revenue and Taxation Committee.

AB 168 (Ridley-Thomas, 2005) would have required: (1) the Board and the Franchise Tax Board (FTB) to each provide to the Legislature, the DOF and the Legislative Analyst Office (LAO), a report, based on a static revenue analysis, of the estimated revenue losses attributable to each tax expenditure, to the extent feasible, that produced a revenue loss in excess of $25 million in the prior fiscal year; (2) the DOF to provide, biennially, to the Legislature and the LAO, a report, based on a dynamic revenue analysis, of the estimated revenue losses attributable to tax expenditures that produced revenue losses in excess of $25 million, as specified; (3) the LAO to review the reports and make recommendations to the Legislature as to which tax expenditures should be modified or repealed.

AB 168 was vetoed by Governor Schwarzenegger and the veto message states:

> "The Department of Finance and the Legislative Analysts Office currently have broad authority to review and report tax expenditures to the Legislature. This bills restatement of the existing tax reporting requirements is redundant and unnecessary."

AB 735 (Arambula, 2005) would have: (1) required the LAO to establish a process to review all tax exceptions, and submit a report to the Legislature by December 31, 2006; (2) required the LAO to review and analyze any relevant reports prepared by the DOF, and request assistance from the Board and the FTB in order to make the report as comprehensive as possible; and (3) directed the Assembly and Senate Revenue and Taxation Committees to review the report submitted by the LAO and authorize them to select a group of tax exceptions for deletion or modification, reporting their recommendations to the fiscal committees for consideration during the budget process. This bill was never heard by a committee.

SB 577 (Figueroa, 2005) would have, among other things, required the DOF, in consultation with the Board and the FTB, to report to the Legislature by January 1, 2008, on the effectiveness of "tax expenditures," as defined. This provision was amended out of the bill.

AB 2106 (Ridley-Thomas, 2004) would have, among other things, required the DOF, in conjunction with the Governor's Budget, to submit to the Legislature a report of tax expenditures currently in effect. The bill would have specified that, among other things, based on information provided by the Board to the extent feasible, the report include the number of tax returns or taxpayers affected by any sales or use tax expenditure, the distribution of that expenditure, and the size and type of business or industry to which that expenditure is made available.

AB 2106 was vetoed by Governor Schwarzenegger and the veto message states:

> "Under existing law, the Department of Finance already is required to provide an annual tax expenditure report to the Legislature containing specific information. This bill changes the type of information that is provided in the annual report. However, some of the information that Department of Finance would be required to report is not available. For example, the original intent of a given tax expenditure is often not clearly defined in the enabling statute. In addition, the number and income distribution of taxpayers benefiting from sales tax exemptions would not be known because this information is not required to be reported by retailers when filing their tax returns. Furthermore, some of the information might not be available for reporting to the Legislature because of existing confidentiality requirements."

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the American Federation of State, County, and Municipal Employees. According to the sponsor, while the annual tax expenditure report prepared by the DOF provides information about tax expenditures, there needs to be a periodic review of those tax expenditures to determine whether they are continuing to serve the public.

2. **Terms "prescription drugs" and "food" need clarifying.** Tax expenditures related to food, prescription drugs, health services, or residential rent would *not* be subject to the review provisions in this bill. What does prescription drugs include? Are prescription drugs limited to medicines and other preparations approved by the

U.S. Food and Drug Administration that are prescribed by a licensed physician and filled by a registered pharmacist?

Under current law, sales and purchases of medicines, medical supplies, and medical appliances are exempt from sales and use tax under specified conditions. For example, many medicinal products, such as surgical soap, sutures, alcohol, Furacin gauze and dressings, that are used by a licensed physician or health facility and applied to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease are exempt from tax, even though these items are not typically thought of as prescription drugs. Additionally, sales of hemodialysis products supplied on order of a licensed physician to a patient by a registered pharmacist are exempt from tax. Sales of insulin and insulin syringes, glucose test strips, or skin puncture lancets furnished by a pharmacist, as direct by a physician, to a diabetic patient for the patient's use in treating diabetes are exempt from tax. Certain prosthetic devices and their replacement parts are considered exempt medicines and their sale is not subject to tax.

Would the above mentioned items be included in the term "prescription drugs?" Board staff is willing to work with the author's office to clarify what medicines and other medical products would be considered prescription drugs and not subject to the Legislative review.

Similarly, "food" is not defined. Is it the same as the current "food products" exemption of Revenue and Taxation Code Section 6359? Or should the Legislature reexamine the extent of the current exemption periodically? For example, at one time, "snack foods" were not considered exempt food products; now they are. Also, there are related exemptions for: hot prepared food products sold to air carriers (Section 6359.1); food products sold through vending machines (Section 6359.2); and ice, dry ice and carbon dioxide used in packing or shipping food products (Sections 6359.7 and 6359.8). Again, Board staff is willing to assist in clarifying the bill's intent.

3. **Technical correction.** Board staff notes a duplication error in the bill. The bill is adding subdivision (d) to Section 13305 related to a definition for "tax expenditure," but the same provision is found under subdivision (b).

COST ESTIMATE

This bill would require the Legislature to review all tax expenditures, as provided, that have been in existence since January 1, 2008, and require any legislative measure creating a new tax expenditure, or extending the operation of an existing tax expenditure, to meet certain requirements, as specified. Unless the Board is asked to assist in providing data on tax exemptions, there is no impact to the Board's administrative costs.

REVENUE ESTIMATE

This bill would not in itself directly change any revenues as further legislation would be required to repeal an ineffective tax expenditure.

Analysis prepared by:	Debra Waltz	916-324-1890	03/20/07
Contact:	Margaret S. Shedd	916-322-2376	

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position